The Commonwealth of Massachusetts

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

February 28, 2006

D.T.E. 06-5

Petition of Massachusetts Electric Company and Nantucket Electric Company for approval of its: (1) annual retail rate filing; and (2) distribution rate adjustment in compliance with Massachusetts Electric Company/Eastern Edison Company, D.T.E. 99-47 (2000).

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FOR: MASSACHUSETTS ELECTRIC COMPANY
AND NANTUCKET ELECTRIC COMPANY
d/b/a/ NATIONAL GRID
Petitioner

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Intervenor

I. INTRODUCTION

On January 27, 2006, Massachusetts Electric Company and Nantucket Electric Company d/b/a/ National Grid (together, "MECo" or "Company") filed with the Department of Telecommunications and Energy ("Department"): (1) a rate reconciliation and adjustment filing with proposed transition charges pursuant to G.L. c. 164, § 1A(a), 220 C.M.R. § 11.03(4)(e), Massachusetts Electric Company, D.P.U./D.T.E. 96-25 (1996), and Nantucket Electric Company, D.P.U./D.T.E. 97-94 (1998); and (2) a distribution rate adjustment in compliance with Massachusetts Electric Company/Eastern Edison Company, D.T.E. 99-47 (2000). Included in this filing are: (1) a reconciliation of the Company's 2005 costs and revenues for transition, transmission, and the default service adjustment factor; and (2) the addition of the residential assistance adjustment factor of 0.010 cents per kilowatt-hour ("KWH") pursuant to Discount Rate Participation, D.T.E. 01-106/D.T.E. 05-55/D.T.E. (2006).[1] The Department docketed the filing as D.T.E. 06-5. The Company's last reconciliation filing was approved subject to further investigation in Massachusetts Electric Company and Nantucket Electric Company, D.T.E. 05-2 (2005).

The Attorney General of the Commonwealth ("Attorney General") intervened as of right pursuant to G.L. c. 12, § 11E. The Department held a public and evidentiary hearing on

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[1] The Company proposes: (1) an average transition charge of 0.546 cents per KWH; (2) an average transmission charge of 0.871 cents per KWH; (3) a default service adjustment credit of 0.045 cents per KWH; and (4) a residential assistant adjustment factor of 0.010 cents per KWH (Exh. MEC-1, at 7).

February 14, 2006. At the evidentiary hearing, the Company sponsored the testimony of Theresa M. Burns, manager of distribution rates and Scott M. McCabe, senior analyst of distribution rates. The Attorney General sponsored the testimony of Lee Smith of La Capra Associates. The Company and the Attorney General filed initial briefs and reply briefs. The evidentiary record consists of 18 exhibits and two responses to record requests.

II. THE COMPANY'S DISTRIBUTION RATE PROPOSAL

A. Introduction

Pursuant to an offer of settlement approved by the Department in D.T.E. 99-47 ("Merger Settlement"),[2] the Company is able to adjust its distribution rates annually, between March 1, 2005 and December 31, 2009, based upon the annual change of a regional index[3] of similarly unbundled distribution companies in New England, New York, New Jersey, and Pennsylvania (Exh. MEC-2, at 56; Merger Settlement, § I.C.3a-b). The regional index was initially calibrated on rates effective July 1, 2004, for investor-owned Northeastern utilities that had unbundled their distribution rates (Merger Settlement, § I.C.3a). The regional index

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[2] The Company and the Attorney General were signatories to the Merger Settlement. The other signatories were the Division of Energy Resources, the Energy Consortium, New England Power Company, and Associated Industries of Massachusetts.

[3] The regional index is a mechanism by which the Company addresses cost increases or decreases that have occurred among investor-owned regional utilities in the Northeastern United States (Exh. MEC-2, at 56; Merger Settlement, § I.C.3a-b). The Merger Settlement allows the Company to match its distribution rates to the other unbundled utilities and to change its distribution rates as the costs of the other utilities in the Northeast change. After the initial calibration on July 1, 2004, MECo calculates the regional index on July 1st of each year from 2005 through 2008 and the adjusted rates are implemented on March 1st of the next year (Exh. MEC-2, at 57; Merger Settlement, § I.C.3a-b).

is normalized for new entrants after the initial calibration in July 2004 so that the Company's relative position in the index is not affected by the unbundling of additional utilities in the region after July 1, 2004 (Merger Settlement, § I.C.3b).

In order for MECo to remove a $10 million credit on March 1, 2005, the Company's average distribution rate could not exceed 90 percent of the regional index (id., n.6). Distribution rate increases after the initial increase are proportional to the change in the regional rate index (Exh. MEC-2, at 56; Merger Settlement, § Att. 8). In the current filing, the Company proposes to increase its distribution rates on average from 2.542 cents per KWH to 2.645 cents per KWH, or an average distribution rate increase to all customers of 4.05 percent (Exhs. MEC-1, at 7; MEC-2, at 60, citing Merger Settlement, § I.C.3b).

One of the distribution companies in the regional index group, Consolidated Edison of New York ("Con Ed") rebundled its distribution and transmission rates in April 2005 as a result of a rate case (Exh. MEC-2, at 62; RR-DTE-2). MECo left Con Ed in the regional index group used to develop its proposed 4.05 percent distribution rate increase (id. at 60). However, in order to account for the fact that Con Edison rebundled its rates in the middle of the year, MECo "unbundled" Con Ed's bundled distribution and transmission rates (Exh. MEC-2, at 62-63). The Company divided Con Ed's bundled distribution and transmission rates between the distribution and transmission functions based on the ratio of Con Ed's July 1, 2004, unbundled distribution rates to the sum of its July 1, 2004, unbundled distribution and transmission rates for each rate class (id.).

B. Positions of the Parties

1. MECo

MECo argues that Con Ed should remain in the regional index for the Company's distribution rate adjustment effective March 1, 2006 (Company Brief at 4-8; Company Reply Brief at 1, 3-4). MECo argues that the initial regional index group was intended to be used throughout the rate index period (i.e., 2005 through 2009) (Tr. at 33). Therefore, MECo argues that, because Con Ed was included in the initial calibration, Con Ed should remain in the regional index group for the duration of the rate index period and that an allocator should be used to determine the amount of the bundled rate to be assigned to distribution rates (Company Brief at 4-8; Company Reply Brief at 1, 3-4; Tr. at 33).

In order to account for the fact that Con Ed rebundled its distribution and transmission rates, MECo argues that it appropriately allocated Con Ed's new rates between the distribution and transmission functions (Company Brief at 3-4, citing Exh. MEC-2, at 9; Company Reply Brief at 4-5). MECo argues that, in calculating this allocation, it was appropriate to assume that Con Ed's transmission costs increased at the same rate as its distribution costs because both functions face similar cost pressures (i.e., both distribution and transmission functions involve the same workforce and involve the same changes in wages and benefits) (Company Brief at 6). The Company contends that the Attorney General's attempt to remove Con Ed from the regional index disregards meaningful information about the movement of current electric distribution rates in the Northeast (Company Brief at 6; Company Reply Brief at 4-5).

2. Attorney General

The Attorney General argues that MECo's inclusion of Con Ed in the regional index is inconsistent with the Merger Settlement because it provides that only companies that have unbundled distribution rates should be included (Attorney General Brief at 4, citing Merger Settlement, § I.C.3a, Att. 8; Attorney General Reply Brief at 1). The Attorney General argues that the Merger Settlement contemplates the addition or the elimination of a utility such as Con Ed after the initial calibration of rates on July 1, 2004 (Attorney General Brief at 6, citing Merger Settlement, Att. 9). The Attorney General argues that because Con Ed rebundled its rates in April 2005, it should be excluded from the regional index (Attorney General Brief at 4; Attorney General Reply Brief at 1-2).

Further, the Attorney General argues that MECo's proposed allocation method created a "fictional" unbundled rate for Con Ed (Attorney General Brief at 4-5; Attorney General Reply Brief at 1-2). Because Con Ed has rebundled its distribution and transmission rates subsequent to July 1, 2005, the Attorney General contends the Company has abandoned any true measure of the movement of distribution rates and, therefore, the Department should remove Con Ed from the 2005 regional rate index (Attorney General Brief at 5; Attorney General Reply Brief at 2).

III. ANALYSIS AND FINDINGS

The Department's authority to consider and approve distribution rates through agreed settlements derives from statute: G.L. c. 164, §§ 76, 93, 94. Rates approved under this broad discretionary authority must conform to the requirements of statute, i.e., they must be "just

and reasonable" and "in the public interest" in order to warrant Department approval. NSTAR Gas and Electric, D.T.E. 05-85, at 28 (2005). While the Department neither would nor should disturb matters established by a settlement approved, the public interest requirement of Chapter 164 remains paramount. Id. at 29. Matters so established remain, at least in principle–and, if need be, in fact–subject to such future adjustment as the public interest may require. The Department has no authority to impair or ignore its own statutory authority or obligations, whether by adjudication or by settlement-approval. Id. By accepting the Department's authority to resolve the instant dispute regarding the makeup of the regional index group, MECo and the Attorney General recognize this fundamental legal concept.

The Merger Settlement provides for an annual adjustment to the Company's distribution rates. Pursuant to the Merger Settlement, MECo must calculate a regional index as of July 1st of each year from 2005 through 2008 (i.e., a weighted average change in distribution rates for all companies in the regional index group) and use this calculation as the basis to adjust its own distribution rates (Merger Settlement I.C.3.b).

The Merger Settlement defines the companies that makeup the regional index as "investor-owned electric utilities with unbundled distribution rates in New England, New York, New Jersey, and Pennsylvania" (Merger Settlement, § I.C.3.a). Further, as a principle for calculating the regional index, the Merger Settlement provides that a utility included in the regional index will be "an investor-owned electric utility in the six New England states, New York, New Jersey, or Pennsylvania with tariffs containing distribution rates and charges that reflect unbundled distribution services comparable to the unbundled distribution services

collected through the electric distribution rates of electric utilities in Massachusetts" (Merger Settlement, Att. 8, at 2).

The Attorney General and MECo, both signatories to the merger settlement, now disagree as to the treatment required pursuant to the Merger Settlement of Con Ed's recent rate increase accompanied by the rebundling of its rates in 2005. Arguing that the Merger Settlement did not provide for the removal of companies from the regional index for reason of rebundling, MECo encourages the Department to keep Con Ed in the regional index group and to "unbundle" its rates using the ratio of its last known unbundled distribution and transmission rates (Exh. MEC-2, at 62). Alternatively, the Attorney General urges us to remove Con Ed from the regional index group altogether because including a bundled utility is inconsistent with the language of the Merger Settlement and also because MECo's attempt to unbundle its rates creates a "fictional" distribution rate for Con Ed (Attorney General Brief at 4; Attorney General Reply Brief at 5-6).

Although the Merger Settlement established a defined class of Northeast electric utilities with unbundled transmission and distribution rates as the regional index group, the Merger Settlement also foresaw that the membership of this group might change. In fact, the Merger Settlement addresses two specific circumstances under which membership in the regional index group would change: (1) the addition of Northeast electric utilities who might later unbundle their rates, and (2) the treatment of a utility who was merged or acquired and where a rate consolidation occurs (Merger Settlement at Att. 8). While the Merger Settlement

does not explicitly provide for the elimination of companies from the regional index because of rebundling, neither does it provide for the use of an allocator to "unbundle" rebundled rates.

As explanation of why rebundling is not explicitly addressed in the Merger Settlement, the Company states that at the time of the settlement negotiations, the parties did not anticipate that any of the unbundled Northeast investor-owned electric utilities would rebundle (Tr. at 45-46). We are not persuaded, however, that the Merger Settlement's failure to specifically address the circumstance of rebundling means that the rebundled Con Ed must remain in the regional index group. The plain and unambiguous language of the Merger Settlement states that the regional index group shall be made up of investor-owned electric utilities with unbundled distribution rates (Merger Settlement, § I.C.3.a; Merger Settlement, Att. 8, at 2). Con Ed no longer has unbundled distribution rates and, therefore, by definition is no longer eligible to be part of the regional index group.[4] The express criterion that the regional index group consist of electric utilities with unbundled distribution and transmission functions precludes the use of bundled or rebundled utilities.

Even if we were to conclude that Con Ed should remain in the regional index group despite its newly-bundled rates, the Department must have substantial evidence to resolve this dispute over what would constitute just and reasonable rates. G.L. c. 30A, § 14(7)(e);

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[4] The Company argues that, as an initial member of the regional index group, Con Ed must remain in the group so as not to disregard "meaningful information" about the true measure of the movement of current electric distribution rates in the Northeast (Company Brief at 6; Company Reply Brief at 4-5). However, at the time the Merger Settlement was negotiated, many Northeast utilities were not included in the regional index due to the fact they were bundled (Merger Settlement, Att. 8, at 3).

G.L. c. 164, § 94. The very reason for originally including Con Ed as one of the many companies on the regional index was to provide an array of objective, outside reference points that are beyond manipulation by any party to the Merger Settlement. Despite the Company's proposed ratio for allocating Con Ed's distribution and transmission rates post-rebundling, we lack a sufficiently firm basis to differentiate between distribution and transmission functions in Con Ed's now rebundled and increased rates. While Con Ed's total bundled rates increased, we have no objective basis for saying what increase to distribution rates might be said to result from changes in Con Ed's rebundled rates (Exh. MEC-2; Tr. 58-59, 70). Therefore, the Company cannot be said to have met its burden to include the rebundled Con Ed in the regional index group.

Absent Con Ed, the regional index group itself remains, as a whole, robust enough and contains a class still sufficiently well-populated to serve its original purpose. Therefore, consistent with the language of the Merger Settlement, the Department directs MECo to remove Con Ed from the regional index to calculate the base rate increase effective March 1, 2006. The removal of a utility, similar to adding a utility, must be normalized so that MECo's relative position in the regional index is not affected by the elimination of the utility. The rate index shall be normalized by removing Con Ed from both the July 2004 rate index and the July 2005 rate index for the purpose of calculating the rate increase effective March 1, 2006.[5]

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[5] The increase to base rates shall be calculated using the method shown in Exhibit MEC-2, at 66.

Regarding the Company's reconciliation of costs and revenues, the Department determines that further investigation is necessary. The Department finds, however, that subject to our further investigation, the rate adjustments filed by the Company on January 27, 2006, with the exception of MECo's proposed transition charge adjustment discussed below, for consumption on and after March 1, 2006,[6] are in compliance with G.L. c. 164, § 1B(b), MECo's restructuring plan approved by the Department in D.P.U./D.T.E. 96-25 and D.P.U./D.T.E. 97-94, MECo's Merger Settlement approved in D.T.E. 99-47, and Department precedent.[7] To avoid a small increase to customers served on rate R-1, the Company proposed to adjust its transition charge adjustment for rate R-1 such that a customer that consumes 500 KWH per month will see no change to their total bill (Exh. MEC-1, at 30). As a result, MECo proposed to lower the transition charge adjustment for rate R-1 by 0.056 cents per KWH (id.). Because the distribution increase allowed per our Order is lower than the distribution increase proposed by the Company, the Company-proposed transition charge adjustment for rate R-1 will result in customers served under this rate to receive a rate decrease at the cost of larger deferrals to be recovered later with interest from the rate R-1 customers.

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6 The Company initially proposed to bill customers for the distribution component of bills on a bills rendered basis instead of a consumption basis. Exh. MEC-1, at 32-33. However, the Company itself recognizes that it is consistent with Department practice to bill customers for distribution rates on a consumption basis (Tr. at 40-42). Billing customers on a consumption basis for distribution rates is also consistent with the Merger Settlement and G.L. c. 164, § 94. Merger Settlement at Att. 8.

7 Because the rate reconciliation and adjustment tariffs also contain MECo's proposed distribution charges, discussed above, the Company must submit new tariffs in compliance with this Order that reflect the change in the distribution charge.

To avoid incurring deferrals higher than necessary to prevent bill increases, the Company may adjust the transition charge adjustment for rate R-1 such that a customer that consumes 500 KWH per month will see no change to their total bill.

As a final matter, pursuant to the Merger Settlement at Section I.C.3b, the Company is required to file its distribution rate index adjustment by January 31st of each year. However, in order to provide for additional time to consider the proposal, the Department requests that all future distribution rate index filing be made by October 1st of each year or as soon thereafter as all pertinent information is available.[8]

IV. ORDER

After due notice, hearing, and consideration, it is

ORDERED: That the tariffs filed by Massachusetts Electric Company and Nantucket Electric Company on January 27, 2006, for effect March 1, 2006, M.D.T.E. Nos. 1089 through 1099, are DISALLOWED; and it is

FURTHER ORDERED: That Massachusetts Electric Company and Nantucket Electric Company shall file new schedules of rates and charges as required by this Order; and it is

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[8] So long as the pertinent data are available, MECo does not object to making its future distribution index filings on October 1st of each year (Tr. at 27-28).

FURTHER ORDERED: That Massachusetts Electric Company and Nantucket Electric Company shall comply with all other directives contained in this Order.

By Order of the Department,

/s/

Judith F. Judson, Chairman

/s/

James Connelly, Commissioner

/s/

W. Robert Keating, Commissioner

/s/

Brian Paul Golden, Commissioner

DISSENT OF COMMISSIONER AFONSO

Today's majority opinion fails to give proper effect to Section I.C.3.a of the Merger Settlement. The issue at hand is whether to include Con Ed in the Company's rate index adjustment.

Several facts are not in dispute: (1) Section I.C.3.a of the Merger Settlement requires the Company to adjust its distribution rates "by an index to an average of investor-owned electric utilities with unbundled distribution rates in New England, New York, New Jersey, and Pennsylvania;" (2) the Merger Settlement established a defined class of Northeast electric utilities with unbundled transmission and distribution rates as the regional index group; and (3) the Merger Settlement addresses two specific circumstances under which membership in the regional index group would change - (a) the addition of Northeast electric utilities that might later unbundle their rates, and (b) the removal of a utility who was merged or acquired and where a rate consolidation occurs (Merger Settlement, Att. 8).

The instant dispute arises because the parties to the Merger Settlement did not contemplate a situation where any of the unbundled Northeast investor-owned electric utilities (such as Con Ed) would rebundle their rates.[9] The Company dealt squarely with this issue at the evidentiary hearing:

> Q: Could you tell me, was the settlement silent on how to address the unbundling - was the settlement silent on the condition of a utility becoming bundled after it was unbundled in the index group?

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[9] Con Ed's rates became rebundled due to an Order issued by the New York Public Service Commission (Exh. MEC-2, at 62).

A: Not only was the settlement and is the settlement silent as to that. I believe, and the Company believes, that the settlement never contemplated that occurring.

(Tr. at 45-46). This important assertion – that the settling parties did not contemplate unbundled Northeast investor-owned utilities from later rebundling their rates – remains unrebutted by the Attorney General. Despite an opportunity to do so, he did not address this assertion in any form. Thus, it is reasonable to conclude that it is not a mere assertion but, in fact, an accurate recitation of the settling parties' intention on this issue to say that they simply did not provide for this eventuality.

We must now deal with the fact that Con Ed rebundled its rates in light of the overall intent of the Merger Settlement. See e.g., Lanier Professional Services, Inc. v. Ricci, 192 F.3d 1 (1999) (The resolution of a contract ambiguity turns on the parties' intent as discerned by the factfinder from the circumstances surrounding the ambiguity and from such reasonable inferences as may be available); Boston Helicopter Charter, Inc. v. Agusta Aviation Corp., 767 F.Supp 363 (1991). As outlined in Section I.C.3.a, the purpose of the regional index is to "adjust the Company's rates in line with the fluctuations affecting the other distribution companies in the Northeast." Further, it is not disputed that Con Ed provides a significant portion of the distribution deliveries in the Northeast and represents 13.5 percent of the regional index. In fact, Con Ed is the largest company in the regional index group (Exh. MEC-2, at 68).

Clearly, removal of Con Ed from the regional index group would remove a significant portion of the index and, thus, such action cannot be said to be consistent with the overall intent of adjusting the rates "in line with the fluctuations affecting the other distribution

companies in the Northeast" (Merger Settlement, § I.C.3.a). Equally clear is the fact that removal of Con Ed from the regional index does not fall within either of specifically enumerated provisions, outlined above, for addition or deletion to the regional index. Accordingly, based on the language of the Merger Settlement, Con Ed should remain in the regional index group.

Having concluded that maintaining Con Ed in the regional index is consistent with the Merger Settlement, I also find that the Company did, in fact, propose a reasonable allocation method for "unbundling" Con Ed's rebundled rates and, therefore, its proposed distribution rate is consistent with our mandate of just and reasonable rates.

Specifically: (1) the Company allocated Con Ed's bundled rates between transmission and distribution functions based on the proportion of distribution and transmission components when the rates were unbundled in July 2004; (2) the Company assumed that the costs in the transmission function for Con Ed increased at the same rate as the costs in the distribution function; (3) both transmission and distribution functions involve the same workforce and involved the same changes in wages and benefits; (4) both functions use and install similar equipment provided by the same vendors; (5) both functions involve the same property taxes and return requirements; and (6) underlying costs associated with each function have increased at an equal rate (Exh. MEC-2, at 62-63, 128; Company Initial Brief at 6).

These assumptions, when taken in the aggregate, provide a reasonable basis to conclude that the underlying costs associated with each function - transmission and distribution - have increased at an equal rate. Accordingly, I would include Con Ed in the regional index

calculation using the Company's proposed allocation. For the reasons set forth above, I respectfully dissent.

/s/

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Paul G. Afonso, Commissioner

In appeal as to matters of law from any final decision, order or ruling of the Commission may be taken to the Supreme Judicial Court by an aggrieved party in interest by the filing of a written petition praying that the Order of the Commission be modified or set aside in whole or in part. Such petition for appeal shall be filed with the Secretary of the Commission within twenty days after the date of service of the decision, order or ruling of the Commission, or within such further time as the Commission may allow upon request filed prior to the expiration of the twenty days after the date of service of said decision, order or ruling. Within ten days after such petition has been filed, the appealing party shall enter the appeal in the Supreme Judicial Court sitting in Suffolk County by filing a copy thereof with the Clerk of said Court. G.L. c. 25, § 5.